REPORT OF

ASSOCIATION FINANCIAL EXAMINATION

PREFERRED PHYSICIANS MEDICAL

RISK RETENTION GROUP, INC.

AS OF

DECEMBER 31, 2003

STATE OF MISSOURI

DEPARTMENT OF INSURANCE

JEFFERSON CITY, MISSOURI

TABLE OF CONTENTS

Mission, Kansas
June 3, 2004

Honorable Alfred W. Gross, Commissioner
Virginia Bureau of Insurance
Chairman of Financial Condition (EX4) Subcommittee
Southeastern Zone Secretary

Honorable Jim Poolman, Commissioner
North Dakota Department of Insurance
Midwestern Zone Secretary

Honorable Scott B. Lakin, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65102

Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

Preferred Physicians Medical Risk Retention Group, Inc.

hereinafter referred to as such, as the "Company" or as "Preferred Physicians". Its administrative office is located at 9000 West 67th Street, Shawnee Mission, Kansas, 66202-3656, telephone number (913) 262-2585. This examination began on March 15, 2004, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of Preferred Physicians Medical Risk Retention Group, Inc. was made as of December 31, 2000, and was

conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC) with no other zones participating.

The current full scope association financial examination covers the period from January 1, 2001, through December 31, 2003, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the NAIC with no other zones participating.

This examination also included the material transactions and/or events occurring subsequent to the examination date which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the State of Missouri prevailed.

The Company's independent auditor, KPMG Peat Marwick LLP, of Kansas City, Missouri, was conducting their audit concurrent with this examination. Consequently, the CPA workpapers were not utilized and no standard procedures were modified.

Comments-Previous Examination

Listed below are comments and recommendations of the previous examination report dated as of December 31, 2000, the Company's response, and findings in the current examination.

Corporate Records

Comment: The Company was directed to ensure that board members review MDI financial examination reports and that this process be reflected in the board meeting minutes.

Company's Response: Board approval of the MDI financial examination reports will be properly reflected in future board meeting minutes. This was inadvertently omitted for the 1997 MDI report.

Current Findings: The MDI financial examination report as of December 31, 2000, was discussed and approved in the March 2, 2002, board of directors' meeting minutes.

Comment: The Company was directed to ensure the board of directors' meeting minutes included a notation that the board reviewed and approved the operational reports of the Company and all committee reports of the board of directors.

Company's Response: Operational reports of the Company and all committee reports of the board, included in the directors meeting minutes, will include a notation that the board approved these reports. This process was implemented during 2001.

Current Findings: The board's approval of the operational reports and committee reports was noted in the review of the board of directors meeting minutes for the period under examination.

Other Assets Pledged as Collateral

Comment: The Company was directed to report all securities pledged or otherwise encumbered in any form, on the Schedule of Special Deposit section of the Annual Statement.

Company's Response: Securities pledged or otherwise encumbered in any form will be reported on the Schedule of Special Deposits section of the Annual Statement. This will commence with the filing of the Annual Statement as of December 31, 2001.

Current Findings: It was noted that the Company did report pledged securities on the Schedule of Special Deposits of the Annual Statements filed during the examination period.

Insurance Products and Related Practices

Comment: The Company was advised to execute an agreement with its field agent located in the State of Kentucky.

Company's Response: The Company feels that the relationship with the agent in Kentucky was best represented by a letter of understanding, as his involvement with the Company was only an accommodation to a policyholder group located there. Nevertheless, because of the MDI's position on the matter, the Company has executed an agreement and licensed the agent.

Current Findings: The Company has an effective agreement with the agent in question.

Ceded Reinsurance

Comment: The Company was directed to comply with Missouri Insurance Regulation 20 CSR 200-1.039 by filing a Supplemental Filing of Material Transactions relating to the termination of a material reinsurance agreement, and henceforth to ensure that it complies with all aspects of Missouri Insurance Laws and Regulations.

Company's Response: The Company inadvertently did not submit the Supplemental Filing for Material Transactions when the reinsurance agreement was terminated. After this was brought to the Company's attention, the required information was submitted.

Current Findings: The Company has filed the required notifications of material transactions with the MDI for the transactions which occurred during the examination period.

Perma Tail Endorsement

Comment: The Company was directed to include the effect of the Perma Tail extended reporting endorsement exposure in future actuarial analysis.

Company's Response: Due to pre-funding there is an unearned premium recorded specifically related to Perma Tail. The exposure the MDI consulting actuary referred to in his report, relates to an unearned premium or premium deficiency concept. This is not related to claims exposure directly and is outside the scope of any loss reserve analysis. The Company does periodically review the pricing exposure related to Perma Tail.

Current Findings: The Company's actuary did not include a review of the Perma Tail extended reporting endorsement in his analysis or report for any of the years under examination. However, since the Company is no longer issuing Perma Tail coverage to new insureds, and the amount of exposure related to the coverage is not considered material, no comment will be made in the current examination.

HISTORY

General

Preferred Physicians Mutual Risk Retention Group, Inc. was incorporated on June 17, 1987, and commenced business on June 22, 1987, as a mutual property and casualty insurance company under the provisions of Missouri Law at Chapter 379 (Insurance other than life). Pursuant to a Plan of Conversion and Reorganization, approved by the Company's policyholders, effective March 14, 1996, the Company was converted from a mutual company to a stock company. The Company changed its name to Preferred Physicians Medical Risk Retention Group, Inc. on the same date. Simultaneously, the Company issued 5,000 shares of common stock, which were acquired by PPM Services, Inc., (PPM Services) a holding company. Ownership of PPM Services was distributed on a pro rata basis per policy to Preferred Physicians policyholders of record on March 14, 1996.

The Company issued an additional 500,000 shares in July 1996, and 295,000 shares in August 1996, to PPM Services. Since Preferred Physicians' policyholders are the sole owners of PPM Services, the Company remains qualified as a risk retention group.

Capital Stock

Preferred Physicians is 100% owned by PPM Services, Inc. All shareholders of PPM Services, Inc. are also policyholders of Preferred Physicians Medical Risk Retention Group, Inc.

As of December 31, 2003, the Company was authorized to issue 2,000,000 shares of $1 par value common stock of which 800,000 shares were outstanding for a total of $800,000 in the Company's common capital stock account.

Dividends

The dividends paid by the Company during the years under examination were as follows:

Years	Amount
2001	-0-
2002	500,000
2003	-0-
Total	$500,000

Management

The management of the Company is vested in a board of directors elected by the sole shareholder. The Company's Bylaws specify that the board of directors shall consist of not less than nine (9) nor more than fifteen (15) persons. The directors of Preferred Physicians elected and serving as of December 31, 2003, were as follows:

Name and Address	Business Affiliation
Thomas B. Davis, MD East Grand Rapids, Michigan	Retired Physician
Joseph. Annis, MD Austin, Texas	Physician
Donn A. Chambers, MD Atlanta, Georgia	Physician
Steven A. Lussos, MD Clifton, Virginia	Physician
Thomas L. Enstrom Topeka, Kansas	Attorney and Management Consultant Enstrom & Associates

Frank X. Fraas Leawood, Kansas	President and Chief Executive Officer Federated Rural Electric Insurance Corp.
Richard A. Kemp, MD Farmington, Connecticut	Physician
Aubrey Maze, MD Phoenix. Arizona	Physician
Edward C. Mills, CPA Tonganoxie, Kansas	President and Chief Executive Officer Preferred Physicians Medical RRG, Inc.
Patrick A. Fantauzzi, MD Albany, NY	Physician
Edward S. Ritter, CPA Olathe, Kansas	Consultant
Jay H. Yedlin, MD Prairie Village, Kansas	Physician

Pursuant to the Bylaws, the board of directors may designate one or more directors to constitute an executive committee or any other committee. An Audit, Actuarial and Compensation Committee and a Nominating Committee were in operation during the period under examination. As of December 31, 2003, the members of each of these committees were as follows:

Audit, Actuarial and Compensation Committee	**Nominating Committee**
Frank X. Fraas	Thomas L. Enstrom
Thomas L. Enstrom	Frank X. Fraas
Edward S. Ritter	

The Bylaws stipulate that the officers of the Company shall consist of a Chairman of the Board, a President, a Secretary, and such other officers, and other assistant officers as the Board may from time to time elect.

The officers elected and serving as of December 31, 2003, were as follows:

Name	Title
Aubrey Maze, MD	Chairman of the Board
Edward C. Mills	President, CEO and Assistant Secretary
Bruce W. Anderson	Vice President-Finance and Treasurer
Brent G. Hodges	Vice President-Underwriting
James F. Johnson	Vice President-Sales
Steve R. Sanford	Vice President-Claims and Secretary

Conflict of Interest

The Company has procedures that require all officers and directors complete a conflict of interest statement annually. Signed statements of officers and directors were reviewed for the period under examination and no material conflicts were indicated.

Corporate Records

A review was made of the Articles of Incorporation and Bylaws for the period under examination. There were no amendments or changes to the Articles of Incorporation during the examination period. The Bylaws were amended and restated in June 2002 to change the date of the annual shareholder meeting.

The minutes of the Company's board of directors and the sole shareholder meetings were reviewed and, in general, appear to properly reflect and approve the corporate transactions and events for the period under examination.

Acquisitions, Mergers and Major Corporate Events

None.

<u>Surplus Debentures</u>

No surplus debentures were issued or outstanding for the period under examination.

AFFILIATED COMPANIES

<u>Holding Company, Subsidiaries and Affiliates</u>

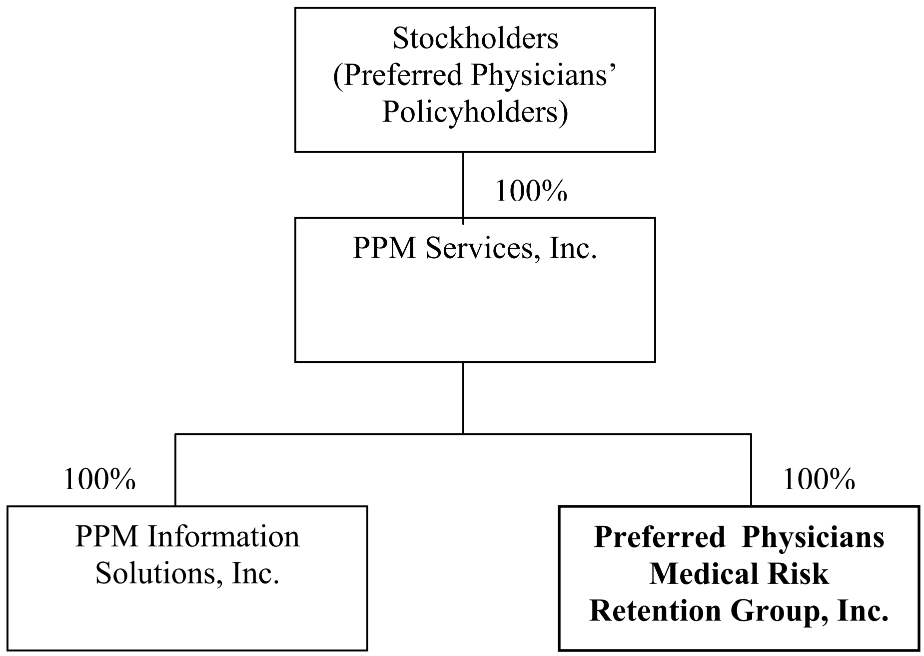
Preferred Physicians Medical Risk Retention Group, Inc. is a member of an Insurance Holding Company System as defined by 382.010 RSMo (Definitions). Preferred Physicians is wholly owned by PPM Services, Inc., which is the ultimate controlling entity within the Company's Holding Company System. All of PPM Services stockholders are also policyholders of Preferred Physicians. No one person holds or owns 10% or more of the voting stock of PPM Services.

PPM Services has one other wholly owned subsidiary, PPM Information Solutions, Inc. (PPM Solutions). PPM Solutions provides information systems and solutions for practicing anesthesiologists.

An Insurance Holding Company System Registration Statement was filed by PPM Services on behalf of Preferred Physicians for each of the years under examination.

Organizational Chart

The following organizational chart depicts the holding company system of Preferred Physicians Medical Risk Retention Group, Inc. as of December 31, 2003:



Intercompany Transactions

Preferred Physicians has entered into the following intercompany agreements:

1. Type: Cost Allocation Agreement

   Parties: PPM Services, Inc. and its wholly owned subsidiaries, Preferred Physicians and PPM Information Solutions, Inc.

   Effective: January 1, 1999

   Terms: Each of the parties to the agreement shall utilize an inter-company general ledger account to record cost allocations of expenses incurred by it and utilized by another participating company. The incurring company shall provide a monthly statement of such allocations to the benefiting company, who shall reimburse the incurring company within thirty (30) days following the receipt of such statement. The cost items to be so allocated are: personnel,

premises, data processing, communications and other operating expenses.

Exception: The agreement specifically states that Preferred Physicians is to lease office space and allocate the costs to the other affiliates. In June of 2003, Preferred Physicians and its affiliates moved to a new location. PPM Services is named as the tenant on the lease at the new location, and PPM Services pays the monthly rent which is then allocated to the other affiliates. In January 2004, the manner in which shared costs are paid and allocated was further altered by having PPM Services pay the salaries of administrative employees who perform work for all of the affiliates. To reimburse PPM Services for providing these employees and other items and services, a flat monthly fee of $65,000 was allocated to Preferred Physicians and a flat monthly fee of $35,000 was allocated to PPM Solutions for the first three months of 2004. At the end of the first quarter of 2004, the total expenses incurred by PPM Services were reviewed, and additional amounts were allocated to both Preferred Physicians and PPM Solutions to cover the cost incurred by PPM Services which exceeded the flat fee amounts. The payment of the flat fee and the expenses of PPM Services is not supported by any intercompany agreement. The Company is directed to restate or amend the Cost Allocation Agreement or enter into a new service/management agreement that reflects the current practices of the Company. The agreement should be filed with the MDI for prior approval as required by RSMo 382.195 (Transactions within a holding company system).

2. Type: Consolidated Income Tax Agreement

   Parties: Preferred Physicians and PPM Services, Inc.

   Effective: March 14, 1996

   Terms: PPM Services shall file a consolidated federal income tax return. Preferred Physicians shall compute its separate tax liability as if it had filed a return on a stand-alone basis, and remit to PPM Services its pro-rata share of the total consolidated tax liability.

3. Type: Revenue Collection Agreement

   Parties: Preferred Physicians and PPM Services, Inc.

   Effective: January 1, 1999

Terms: Preferred Physicians collects funds for the purchase of PPM Services stock along with premium collections from policyholders. The agreement requires Preferred Physicians to account for the monies attributable to the stock purchase under 'funds held' in its books and records. The agreement further obligates Preferred Physicians to remit the funds to PPM Services within fifteen days (15) following the end of the month in which the related premium is recorded. The Company does not charge PPM Services any fees for collecting these monies.

The amounts (paid) to and received from parent and affiliates during the period under examination were as follows:

	2003	2002	2001
Cost Allocation Agreement:			
Received from PPM Services	$362,596	$285,152	$175,754
Received from PPM Solutions	29,633	205,409	208,605
Revenue Collection Agreement:			
Paid to PPM Services	(832,875)	(708,750)	(457,950)
Consolidated Tax Allocation Agreement:			
Paid to PPM Services	(1,630,218)	-0-	-0-
Dividend Payment:			
Paid to Sole Shareholder			
(PPM Services)		(500,000)	-0-
Capital Contribution			
Received from PPM Services	500,000	-0-	-0-
Net Amount (Paid) or Received	**($1,570,864)**	**($718,189)**	**($73,591)**

FIDELITY BOND AND OTHER INSURANCE

Preferred Physicians is a named insured, along with its parent, PPM Services and affiliate, PPM Solutions on a financial institution bond with a liability of $500,000 and a $25,000 single loss deductible. The fidelity bond coverage does not meet the amount suggested in the guidelines promulgated by the NAIC, which is between $700,000 and $800,000 in coverage. The Company should increase its fidelity bond coverage to meet the suggested NAIC amounts.

Preferred Physicians is also a named insured along with PPM Services and PPM Solutions on various other standard insurance policies. These additional policies include, but are not limited to the following:

- Workers Compensation
- Directors and Officers Liability
- Commercial Package Policy:
  - Business Personal Property
  - Business Income
  - Tenant's Liability
  - Accounts Receivable
  - Papers and Records
  - Personal Computer Coverage
- Commercial Umbrella Liability
- Errors and Omissions
- Inland Marine

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

Preferred Physicians Medical Risk Retention Group, Inc. provides the following benefits to its employees: major medical, term life and accidental death and dismemberment insurance, educational assistance, paid holidays, paid time off and a Section 125 Plan. The Section 125 Plan allows for contributions toward insurance premium, out-of-pocket medical expenses and dependent care expenses. The Company also offers a 401(k) Savings Plan to all employees after six months of employment. Under the Plan, the Company will match employee contributions at 60% up to a maximum of 3% of eligible wages. The Company may also make additional discretionary contributions to the Plan. For each of the years under examination, the Company discretionarily matched 100% of employee contributions, up to a maximum of 5% of eligible wages. In addition, the Company made discretionary profit sharing contributions of 2% for the years 2002 and 2003 based on the Company's operating results.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance as of December 31, 2003, as reflected below, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with RSMo Section 379.098 (Securities deposits). The funds on deposit as of December 31, 2003, were as follows:

Type of Security	Par Value	Fair Value	Statement Value
U.S. Treasury Notes	\$1,000,000	\$1,017,996	\$1,060,00

Deposits with Other States

The Company had no funds on deposit with other states.

Other Deposits

The Company obtained a letter of credit from Bank of America to satisfy part of an appeal bond requirement pursuant to a case in the District Court of Harris County, Texas. The following security is held by the bank as collateral for the letter of credit as of December 31, 2003:

Type of Security	Par Value	Fair Value	Statement Value
Bank of America CD	\$1,360,189	\$1,360,189	\$1,360,189

The Company also has a cash appeal bond held by the District Court of Harris County, Texas in the amount of \$228,657 and a cash appeal bond held by the District Court of Cameron County, Texas, in the amount of \$216,666.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

Preferred Physicians is licensed under Chapter 379 RSMo (Insurance other than life), to write the business of property and casualty insurance in the State of Missouri. The Company is authorized as a risk retention group in over forty other states, and actively writes business in 34 states. As of December 31, 2003, approximately 52% of the Company's direct written premiums were concentrated in six states: Arizona, Florida, Illinois, New York, Texas and Virginia.

The Company offers medical malpractice insurance to anesthesiologists exclusively, utilizing direct mail and an in-house sales force. The Company also has a field agent in the State of Kentucky and in the State of Florida.

The Company's policies are issued primarily on a claims-made basis. Policyholders can also purchase an extended reporting endorsement which provides coverage on an occurrence basis. As of December 31, 2003, approximately 89% of net premiums written were on a claims made basis with the remaining 11% being on an occurrence basis.

As a risk retention group, policyholders of Preferred Physicians are required to purchase stock in the Company's parent, PPM Services, Inc. As of the December 31, 2003. Preferred Physician policyholders were required to purchase a total of $3,600 in PPM Services, Inc. stock over a four year period.

Policy Forms and Underwriting
Advertising & Sales Material
Treatment of Policyholders

The Missouri Department of Insurance has a market conduct staff, which performs a review of these issues and generates a separate market conduct report. However, the Company has not had a market conduct examination performed since its inception.

A cursory review was made of several market conduct related areas of the Company during the course of this examination. No problems were noted.

REINSURANCE

General

The Company's reinsurance and premium activity during the period under examination are as follows:

Premiums:	2003	2002	2001
Direct Business	$30,892,974	$24,905,231	$21,607,972
Reinsurance Assumed	-0-	-0-	-0-
Reinsurance Ceded	(13,147,690)	(8,894,643)	(7,108,010)
Net Premiums Written	$17,745,284	$16,010,588	$14,499,962

Assumed

The Company does not assume any business.

Ceded

The Company is contingently liable for all reinsurance losses ceded or retroceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

Effective January 1, 2000, the Company entered into a reinsurance agreement with Hannover Ruckversicherungs-Aktiengesellschaft (Hannover Re) and Swiss Reinsurance America Corporation (Swiss Re), utilizing Benfield Blanch as intermediary. Effective January 1, 2002 Swiss Re was replaced by Transatlantic Reinsurance Company (Transatlantic Re) as a participant to the agreement.

Under the January 1, 2002 agreement, Hannover Re and Transatlantic Re are each obligated for a 50% participation of the losses in excess of the Company's retention of $300,000 per claim up to a limit of $700,000 per claim and $2,200,000 aggregate as respects each insured, each claim. In addition, and as respects policies with limits greater than $1 million for New York state insureds, the Company's retention is the first $1 million, with Hannover Re and Transatlantic Re assuming 90% of the amount by which the ultimate net loss exceeds the Company's retention up to a limit of $1,170,000 each insured, each claim. For policies issued to insureds domiciled in the Commonwealth of Virginia with limits greater than $1,000,000, the Company's retention is the first $1 million, with Hannover Re and Transatlantic Re assuming 90% of the amount by which the ultimate net loss exceeds the Company's retention up to a limit of $900,000 each insured, each claim.

The Company entered into a new reinsurance agreement effective January 1, 2004. The new agreement is essentially the same as the prior agreement except that Endurance Reinsurance Company was added as a 25% participant to the treaty, and Hannover Re's participation rate was decreased to 25%. In addition, Aon Re replaced Benfield Blanch as intermediary.

For policies with limits in excess of $1 million in states other than New York, General Reinsurance Corporation provides facultative reinsurance on a risk by risk basis. The Company retains no risk related to facultative cessions.

ACCOUNTS AND RECORDS

Independent Auditor

The Company's financial statements were audited by the CPA firm of, KPMG, LLP, of Kansas City, Missouri for all the years in the examination period.

Independent Actuary

The loss reserves were reviewed and certified by Terrence M. O'Brien, FCAS, MAAA, CPCU of PriceWaterhouseCoopers, LLP, of Chicago, Illinois as of December 31, 2003, 2002 and 2001.

General

During our review of the Company's cash and investment accounts, it was noted that the Company's custodial agreement with US Bank had not been updated to reflect name changes of both the Company and the custodial bank. In addition, the agreement did not contain all of the safeguard provisions specified in Part 1, Section IV of the NAIC Financial Condition Examiners Handbook. The Company should amend or restate the custodial agreement with US Bank so that it reflects the current name of the Company and of the custodian. In addition, the Company should ensure the amended/restated agreement contains all of the NAIC specified safeguard provisions.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2003. Any examination adjustments to the amount reported in the Annual Statement and/or comments regarding such are made in the “Notes to the Financial Statements”. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been additional differences found in the course of this examination that are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial concerning their effect on the financial statements, and therefore, were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

Assets

	Assets	Non-Admitted Assets	Net Admitted Assets
Bonds	$92,885,863	$2,156,699	$90,729,164
Cash and short-term investments	19,512,018		19,512,018
Investment income due and accrued	990,145		990,145
Amounts recoverable from reinsurers	440,295		440,295
Net deferred tax asset	4,344,844	2,170,306	2,174,538
Electronic data processing equipment and software	61,674		61,674
Furniture and equipment, including health care delivery assets	45,263	45,263	-0-
Receivable from parent, subsidiaries and affiliates	34,866		34,866
Aggregate write-ins for other than invested assets:			
Due from others	12,488		12,488
Reorganization cost	13,077	13,077	-0-
Appeal bonds	445,323	-0-	445,323
Total Assets	**$118,785,856**	**$4,385,345**	**$114,400,511**

Liabilities, Surplus and Other Funds

Losses	$45,946,955
Loss adjustment expenses	22,515,820
Other expenses	873,674
Taxes, licenses and fees (excluding federal and foreign income taxes)	300,343
Current federal and foreign income taxes	416,312
Unearned premiums	3,525,149
Advance premiums	6,695,255
Ceded reinsurance premiums payable	8,331,245
Amounts withheld or retained by the company on account of others	1,272,939
Payable to parent, subsidiaries and affiliates	4,500
Total Liabilities	**$89,882,192**
Common capital stock	800,000
Gross paid in and contributed surplus	13,094,730
Unassigned funds (surplus)	10,623,589
Surplus as regards policyholders	**$24,518,319**
Total liabilities and surplus	**$114,400,511**

Statement of Income

Premiums earned	**$18,065,501**
DEDUCTIONS	
Losses incurred	8,344,699
Loss expenses incurred	8,595,815
Other underwriting expenses incurred	3,498,223
Total underwriting deductions	**$20,438,737**
Net underwriting gain/(loss)	**($2,373,236)**
Net investment income earned	$4,399,598
Net realized capital gains or (losses)	1,009,558
Net investment gain or (loss)	**$5,409,156**
Federal and foreign income taxes incurred	1,104,681
Net income	**$1,931,239**

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002	$22,206,331
Net income	1,931,239
Net unrealized capital gains or (losses)	(81,433)
Change in net deferred income tax	84,622
Change in nonadmitted assets	(122,440)
Paid in capital	500,000
Net change in surplus as regards policyholders for the year	**$2,311,988**
Surplus as regards policyholders, December 31, 2003	**$24,518,319**

NOTES TO THE FINANCIAL STATEMENTS

None.

EXAMINATION CHANGES

None.

GENERAL COMMENTS AND/OR RECOMMENDATIONS

Intercompany Transactions (Page 11)

The Company is directed to restate or amend the Cost Allocation Agreement or enter into a new service/management agreement that reflects the current practices of the Company. The agreement should be filed with the MDI for prior approval as required by RSMo 382.195 (Transactions within a holding company system).

Fidelity Bond (Page 12)

The Company should increase its fidelity bond coverage to meet the suggested NAIC amounts of between $700,000 and $800,000 in coverage.

General (Page 18)

The Company should amend or restate the custodial agreement with US Bank so that it reflects the current name of the Company and of the custodian. In addition, the Company should ensure the amended/restated agreement contains all of the NAIC specified safeguard provisions.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Preferred Physicians Medical Risk Retention Group, Inc. during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Barbara Bartlett, CPA, Andy Balas, CFE, and James Smith, examiners for the Missouri Department of Insurance, participated in this examination. The actuarial firm of Milliman, USA, Inc. in Dallas, Texas also participated as a consulting actuary.

VERIFICATION

State of Missouri)
)
County of)

I, Mark A. Nance, CPA, CFE, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

____
Mark A. Nance, CPA, CFE
Examiner-In-Charge
Missouri Department of Insurance

Sworn to and subscribed before me this _______day of ________, 2004.

My commission expires: ________________ _________________________
Notary Public

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

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Frederick G. Heese, CFE, CPA
Audit Manager
Missouri Department of Insurance